warranted. USTA's current streamlining proposals, while a step forward in acknowledging that objective "metrics" should be applied, are both entirely premature and thoroughly inadequate under the stringent analyses the Commission has previously employed.

II. THE COMMENTS CONFIRM THAT THE LEC PRICE CAP PLAN SHOULD BE MODIFIED TO ACHIEVE THE GOALS OF INCENTIVE REGULATION.

In addition to demonstrating the need to retain price cap regulation for so long as the LECs have no viable competition for local exchange and exchange access services, the comments make clear that the Commission should further strengthen its existing regulation of those carriers to assure that access customers receive just, reasonable and non-discriminatory access rates. In particular, the record shows the need for an upward adjustment in the productivity offset in the LECs' price cap equation, coupled with a revision to the formula for capping common line rates; modification of the sharing thresholds, and an adjustment in the LECs' current PCIs to reflect the reduction since 1990 in those carriers' cost of capital; and modest revisions in the LECs' basket and band structure, accompanied by measured changes in exogenous treatment for certain LEC costs.

A. The LECs' Productivity Factor Should Be Increased To 5.47 Percent, Unless The Common Line Formula Is Also Revised To Provide Appropriate Incentives For Efficiency.

As the NPRM (¶ 44) correctly observed, the price cap LECs' earnings under incentive regulation have increased markedly over the levels those carriers achieved under rate of return, despite the relatively weak national economy. Moreover, the Commission pointed out (id.) that other factors, such as the recent general decline in interest rates and expected improvements in LEC productivity as network usage increases with the economic recovery, can be expected to improve these earnings results. In light of these developments, the Commission concluded (¶ 45) that "there may be a good case" for increasing the LECs' current minimum and optional productivity factors.

The record developed in this proceeding abundantly bears out the Commission's suggestion that an increase in the LECs' productivity offsets is warranted. As AT&T's Comments demonstrated (pp. 23-26 and Appendices B-C), analysis of the price cap LECs' achieved productivity based on their own data filed with the Commission shows that those carriers' performance reflects aggregate productivity of approximately 5.97 percent from January 1991 to December 1993.[42] This

[42] Although these productivity calculations are based on data for the BOCs, nothing indicates that a separate

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level far exceeds the 3.3 percent minimum productivity offset under which most LECs now operate, as well as the 4.3 percent optional offset which the Commission adopted with the intention of creating a "substantial financial incentive" for LECs electing that treatment to further improve their productivity.[43] AT&T also showed that the LECs' achieved productivity under price caps closely mirrors the levels reflected in the historical studies of those carriers' performance developed in the original price cap proceeding. Taken together, this evidence demonstrates compellingly the need for a significant upward adjustment in the "X" factor of the LEC price cap formula.[44]

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offset is warranted for other price cap LECs. See AT&T Comments, p. 24.

43 See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6801-6802 (1990) ("LEC Price Cap Order"), recon. 6 FCC Rcd. 2637, 2652-53 (1991).

44 In the absence of any adjustment in the current "Balanced 50/50" formula (see pp. 31-33 infra), AT&T suggests that the Commission increase the productivity factor to 5.97 percent, less a .5 percent "productivity dividend" to encourage LECs to continue to operate efficiently. AT&T Comments, p. 26. This overall productivity level provides the LECs ample incentives to maintain and improve their current performance levels because it is based on an earnings level of 11.25 percent, even though the LECs' current cost of capital is less than 10 percent. See id., pp. 29-32 and Appendix D; pp. 35-37 infra.

Other comments also confirm the necessity of adopting an increase of this or similar magnitude in the LECs' productivity adjustment. For example, based on its analysis of the LECs' realized returns under incentive regulation, MCI points out (pp. 23-26) that "it is clear the Commission was overly conservative in its [initial] choice of productivity factor," and urges the Commission to increase the overall productivity offset to 5.9 percent.[45] Similarly, ICA concludes (p. 12) that the Commission was "overly cautious" in its original selection of the offset, and contends that the LECs' minimum productivity factor "should be raised to at least 5.5% a year . . . ."[46] Other IXCs,[47] government

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45 MCI's analysis of the necessary correction in the productivity factor is based on the Commission's study in Docket 87-313 of LEC switched access rates, adjusted to eliminate discrepant 1984 data. This procedure results in an upper bound for LEC productivity (before application of a productivity dividend) of 5.43 percent -- virtually identical to the figure developed by AT&T's analysis of LEC productivity for the 1991-93 period.

46 ICA also suggests (id.) that the Commission's current .5 percent consumer productivity dividend in the LECs' X factor should be immediately increased to .75 percent, with a further increase to 1.0 percent after two years, to better provide the intended benefits of incentive regulation to access customers.

47 Sprint, p. 12 (stating that if the sharing mechanism is eliminated, "there should be some appropriate upward adjustment in the productivity factor to reflect the resulting increase in the LECs earning potential"); WilTel, pp. 24-25 (pointing out that LEC earnings under price caps "are far above where they would have been under rate of return," and that the Commission should use data collected in this

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agencies,[48] and customer representatives[49] all conclude, based on a variety of analytical approaches, that the current productivity offsets are far too low to achieve the Commission's stated objective of assuring that ratepayers benefit meaningfully from price cap regulation.

Predictably, the opposition to increasing the minimum productivity factor from its present 3.3 percent

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proceeding "to raise the productivity factor to more accurately reflect the declining cost characteristics of telecommunications networks over time").

48 GSA, pp. 8-10 (composite LEC earnings growth above 11.25 percent under price caps demonstrates LEC productivity has consistently exceeded the Commission's current offsets, and has averaged 4.9 percent; OCCO, p. 7 (LECs' higher earnings under price caps shows market is not competitive, and requires high productivity offset as a "'surrogate competitive' discipline"); PaOCA, pp. 6-7 (existing minimum and optional interstate offsets are "inadequate and understated" in light of data compiled in pending state price cap proceeding indicating 6.0 percent offset is appropriate for Bell Atlantic there). In fact, on June 8, 1994 the California Public Utilities Commission raised Pacific Bell's productivity factor under that state's incentive regulation plan from 4.5 percent to 5.0 percent.

49 Ad Hoc, pp. 18-24 (current productivity factors are "unreasonably low and unnecessarily generous to LECs" in light of LEC earnings consistently higher than 11.25 percent, lower growth in LEC input prices relative to GNP-PI, and productivity enhancements in newer telecommunications technology); ARINC, pp. 2-3 (experience under price caps demonstrates the Commission erroneously rejected higher productivity offsets proposed in Docket 87-313; X factor should be increased to between 5 and 6 percent).

level all comes from the price cap LECs themselves. These carriers contend that increasing the offset is tantamount to attempting to "recapture" their productivity gains achieved during the past four years, and claim that if the offset is increased the LECs' incentives to invest or innovate will be substantially blunted.[50]

These arguments are based on the erroneous claim that the LECs' productivity performance in excess of the 3.3 percent threshold has been solely attributable to the efficiency incentives generated by price cap regulation.[51] In fact, as shown above and in AT&T's Comments, the Commission's own studies in Docket 87-313 demonstrate that under rate of return regulation from 1984 through 1990 the LECs consistently achieved productivity levels in excess of 5 percent.[52] The LECs' continued ability to perform at these levels under price cap regulation merely shows that the "X" factor adopted

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50 Pacific Companies, p. 29; Ameritech, pp. 12-13; SWBT, pp. 38-39.

51 Paradoxically, USTA itself belies this premise by arguing (p. 45) that "the efficiency incentives under the current plan are only marginally better than under rate of return regulation." The LECs' substantially higher profits under incentive regulation thus could not be attributed to a "marginal" increase in efficiency incentives.

52 See LEC Price Cap Order, 5 FCC Rcd at 6797 (¶¶ 83, 86-87).

by the Commission in the LEC Price Cap Order considerably understates the LECs' historical productivity. Raising the offset as AT&T and other commenters have proposed will simply mirror the LECs' higher long-term performance, without depriving those carriers of legitimate incentives to operate even more efficiently.[53]

There is even less justification for the LECs' astonishing assertion that the productivity offset should be reduced to just 1.7 percent, and the consumer productivity dividend eliminated. The sole basis for this claim is a USTA sponsored economic study that measures the total factor productivity ("TFP") of the RBOCs and compares those results to economy-wide TFP over the period 1984-92.[54] USTA then makes the unsupported claim that this TFP differential should be substituted for the "X" factor in the Commission's price cap equation. However, as explained below and in Appendix C, the Christensen Study and USTA's arguments based on it are flawed in numerous respects and provide no basis for

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53 Nor is there any merit to the LECs' claim that increasing the productivity offset would "recapture" any part of their $2.5 billion in additional revenues achieved under price cap regulation; that modification would solely operate prospectively to assure that ratepayers receive at least the same level of benefits available under rate of return regulation.

54 See L. Christensen, P. Schoech and M. Meitzen "Productivity of the Local Operating Companies Subject to Price Cap Regulation", May 3, 1994 (USTA Comments, Attachment 6) ("Christensen Study").

the Commission to refrain from increasing the LECs' productivity factor -- much less for drastically reducing the current offset.

As a threshold matter, USTA seriously misrepresents the applicability of its TFP analysis for use in the Commission's price cap formulae. In fact, the Christensen Study's TFP differential calculation differs markedly from the manner used to calculate the LECs' productivity offset in the price cap formula.[55] Specifically, the X factor is a productivity offset against the GNP Fixed Weight Price Index ("GNP-PI"), while TFP is computed relative to actual LEC input price changes. Thus, to derive a TFP-based measure that

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55 Significantly, even USTA's economists stop well short of equating the TFP computation with the X factor calculation. The Christensen Study (pp. 81-82) merely states that "[c]onceptually, the productivity offset in the price cap formula is related to the differential in productivity growth achieved by the price cap local exchange carriers and the U.S. economy" (emphasis supplied). While the two may be "related," it is clear that they are not equivalent, as USTA's own economist has implicitly acknowledged in prior price cap submissions to the Commission. See AT&T Comments filed October 19, 1987 in Policies and Rules for Rates of Dominant Carriers, CC Docket No. 87-313, Appendix F, p. 10 (comparing input-price inflation of Bell System with that for U.S. private domestic economy).

USTA's other economic attachment, prepared by NERA, also disavows any equivalency between the TFP differential and the LEC "X" factor, noting that such a relationship can be made only if the growth rate of LEC input prices matches the growth rate of input prices in the general U.S. economy. See USTA Attachment 5, pp. 8-9.

corresponds to the price cap "X" factor, TFP differentials must be adjusted for the difference between GNP-PI and actual input price growths. Such an adjustment adds 3.5 percent to the productivity offset calculated by the Christensen Study, and results in an implied "X" factor of at least 5.2 percent.[56]

Additionally, USTA's TFP calculation is based on alleged "economic" rates of depreciation that may differ significantly from the levels now permitted by the Commission for price cap LECs.[57] This may create the

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56 Because LEC earnings rose to supranormal levels during the 1991-92 period, an additional upward adjustment in the Christensen Study's TFP figure is also required.

Moreover, for the TFP differential to be applicable for purposes of computing the productivity factor, it should measure output in the same fashion as the PCI calculation. However, the Christensen Study uses a revenue weighting for common line rates -- which represent approximately half the LECs' interstate revenue requirement -- that does not match the current "Balanced 50/50" formula for setting these rates under price caps, or even the Commission's ratesetting methodology under rate of return regulation. This serious discrepancy precludes valid comparison of the Christensen Study's results with either the LECs' performance under price caps or with their prior productivity record.

57 Simplification of the Depreciation Prescription Process, CC Docket 92-296, Report and Order, FCC 93-452, released September 23, 1993. In this respect, the LECs' reliance on the Christensen Study is simply an attempt to circumvent the Commission order by negating that decision's effect through a reduction in the value of the X factor in the price cap equation. For the same reason, the Commission should reject the claims by Ameritech (p. 13), Pacific Companies (pp. 30-31), and SWBT (p. 41) that

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appearance that these carriers are consuming capital differently, and thus achieving different TFPs, than would be the case if the LECs used the Commission's approved depreciation rates. Further, the Christensen Study's TFP calculation relies on the LECs' data at the total company level, rather than amounts specific to those carriers' interstate access services. This necessarily understates the LECs' interstate access TFP growth because, as the Christensen Study concedes (Attachment 1, p. 8), "growth in high markup services" -- such as access -- "contributes more to TFP growth than growth in low markup services," such as those included in the total company level data. In view of these important methodological deficiencies, the Christensen Study cannot be considered a valid measure of the LECs' productivity, and provides no support for the LECs' proposal to reduce their current productivity offset.

In sum, the LECs have offered no persuasive rebuttal of the overwhelming evidence showing that the current X factor seriously understates those carriers' historical productivity.[58] The Commission should

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their productivity under price caps is distorted by unreasonably low depreciation rates.

58 Equally unpersuasive is the suggestion by GTE (p. 74), SNET (p. 14), and USTA (p. 82) that the cable industry's productivity factor of 2 percent provides a useful benchmark for LEC productivity.

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therefore modify its price cap formula to establish the productivity offset at 5.97 percent to reflect the LECs' achieved productivity level in the past three years of incentive regulation, less a .5 percent "productivity dividend" to encourage further efficiency gains by these carriers.

The LECs have likewise failed to rebut the need for modification of the current "Balanced 50/50" formula for capping common line rates, as proposed by the Commission (NPRM, ¶¶ 58-59). AT&T demonstrated (pp. 26-28) that common line minute growth under the current formula has declined substantially from its levels prior to the adoption of incentive regulation -- a result that is completely at odds with the Commission's objective of encouraging the LECs to stimulate common line demand. MCI likewise agrees (pp. 35-37) that the current common line capping method "unduly minimizes the contribution that IXCs make to common line growth stimulation, and observes that the past four years' record proves that "the LECs were incapable of stimulating demand to the level anticipated" by the Balanced 50/50 formula. Other

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These commenters conveniently overlook that, in addition to establishing this productivity factor for cable companies, the Commission also required those carriers to reduce their rates by 17 percent.

commenters endorse these conclusions,[59] and support substituting a per-line capping formula that will create more powerful incentives for LECs to improve efficiency and control costs.[60]

No LEC provides any evidence to contradict these showings, or to prove that the LECs have contributed to stimulating common line demand during the four years the Balanced 50/50 formula has been in effect. Nor do these parties even demonstrate that the current formula creates appropriate incentives for LECs to improve their efficiency, and thus to stimulate common line minute growth. To the contrary, NYNEX claims (p. 49) that changing to a per-line capping formula would be undesirable precisely because under such that mechanism "LECs would be incented to focus on cost reduction," instead of allocating their resources to additional network upgrades. NYNEX's argument is especially

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59 Sprint, pp. 5, 15-17; WilTel, p. 26.

60 See ICA, pp. 15-16. The record also substantiates that the LECs' productivity factor can be modified if an appropriate common line formula is adopted in lieu of the Balanced 50/50 formula. Based on such a change, AT&T suggested (p. 26) a reduction of approximately .8 percent in the productivity offset of 5.47 percent reflected by the LECs' historical performance. MCI suggests (p. 39) reducing the productivity factor by approximately .5 percent if a per-line formula is adopted. Sprint likewise recognizes (p. 5) that an offsetting change in the productivity will be necessary if a change is implemented in the common line capping mechanism.

astonishing because it has acknowledged elsewhere that its cost structure, and hence its interstate access rates, are seriously overstated.[61] However, it demonstrates graphically the need for the Commission to revise its common line formula to adopt a per-line capping mechanism that will meaningfully strengthen the incentives for LECs to improve their productivity.

B. The Sharing Mechanism Should Be Retained, Accompanied By A One-Time Adjustment In LEC Rate Levels.

As the NPRM noted (¶ 52), since the inception of incentive regulation the price cap LECs have expressed strong opposition to the sharing mechanism established by the Commission in the LEC Price Cap Order, and have repeatedly called for its elimination. Although the NPRM requested comment on whether to eliminate the sharing mechanism altogether, the Commission also acknowledged (¶ 53) the integral relationship between the sharing mechanism and the need for establishing the productivity factor at an appropriate level. Moreover, the Commission noted (¶ 54) that the sharp decline since 1988 in the LECs' cost of capital appeared to warrant a realignment of the current sharing thresholds.

The record amply confirms the correctness of the Commission's observations. As AT&T showed

61 See NYNEX Transition Plan to Preserve Universal Service in a Competitive Environment, filed December 15, 1993.

(pp. 29-30), a principal purpose of the sharing mechanism is to guard against an inadvertently inadequate productivity factor and thus to maintain appropriate incentives for continued productivity on the LECs' part. MCI also states (pp. 31-32) that, because the likelihood of individual LEC deviations from the Commission's industry-wide offset is likely to increase over time, there is a continuing need for the sharing mechanism to protect ratepayer interests.[62] Indeed, even the LECs, who maintain their steadfast opposition to the sharing mechanism, in many cases acknowledge the linkage between sharing and the selection of the correct productivity offset.[63]

The record also fully supports the need for adjusting the LECs' PCIs and sharing thresholds to reflect changes in the LECs' cost of capital. In its comments, AT&T presented (pp. 31-32 and Appendix D) a discounted cash flow analysis showing that the LECs' cost of capital declined to 9.93 percent between 1991 and 1993, and on this basis requested a reduction of $322 million in the LECs' price cap indices. Similarly,

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62 As MCI correctly points out (p. 32), however, the significant upward adjustment in the X factor supported by the record in this docket should significantly reduce the need for recourse to the sharing mechanism -- and would ultimately eliminate the need for it altogether.

63 BellSouth, p. 48; GTE, p. 67; Ameritech, pp. 14-15.

MCI's discounted cash flow analysis, covering the period since 1990, indicates (p. 29) that the LECs' current cost of capital is no higher that 9.54 percent, and GSA (pp. 4-7) also provides strong evidence that the LECs' cost of capital has declined significantly.

No LEC disputes that its cost of capital has, in fact, declined dramatically since the inception of price cap regulation. Some of these carriers assert, however, that this change should not be reflected as an adjustment to their PCIs and sharing thresholds because those interest rate reductions were already included in the GNP-PI used to calculate their indices.[64] However, no LEC provides any evidence in support of this assertion.[65]

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64 See Pacific Companies, pp. 40-45; BellSouth, p. 48.

65 NERA's study for USTA (Comments, Attachment 5) contends (pp. 25-26) that, although the LECs may have benefited disproportionately from a decline in the economy-wide cost of capital, other LEC costs that are under-reflected in the GNP-PI may have risen. USTA and NERA conclude (p. 26) that it would be inappropriate to single out a specific cost item (e.g., capital costs) for exogenous treatment without analyzing all of a LEC's costs. They also aver that because such an analysis is infeasible (or would amount to "recapture" of past LEC productivity gains), the only practical solution is to forego making any exogenous adjustment on this basis.

USTA and NERA ignore the fact that since the inception of price caps, the LECs have made numerous filings seeking exogenous treatment of cost items that they alleged affect them substantially more than was reflected in GNP-PI; however, in no case did these carriers provide a comprehensive analysis of their costs such as that NERA suggests would be

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Equally unsupported is the LECs' argument that adjustments to their PCIs to reflect a lower cost of capital would amount to "recapture" of their profits achieved under price cap regulation. First, as shown above those profits resulted from both a lower cost of capital and an inadequate productivity offset, rather than efficiencies achieved by the LECs. Moreover, the change in these carriers' price indices and sharing thresholds that AT&T and other parties seek is prospective only, and would not "recapture" any past reductions in their cost of capital. Because the LECs have failed to rebut either the fact that their cost of capital has declined or to present any reasoned basis for permitting them to retain these cost savings, the Commission should immediately reduce these carriers' PCIs by $322 million to reflect this change,[66] and reduce their sharing thresholds to assure that incentive regulation will continue to protect access ratepayers.

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required. Indeed, despite NERA's claim that it would be improper to single out specific costs for exogenous treatment, the LECs have claimed such treatment for Other Post-employment Benefits ("OPEB") based on a NERA study that made no analysis of how changes in other LEC cost items were reflected in the GNP-PI.

66 As AT&T showed (Comments, Appendix E), this $322 million adjustment represents the portion of the LECs' cost of capital reduction that was <u>not</u> reflected in the GNP-PI.

C. To Assure Reasonable And Nondiscriminatory Rates, Only Measured Improvements To The Existing LEC Price Cap Rules And Basket And Band Structures Need Be Implemented.

Many commenters show, as did AT&T (pp. 38-40), that there is no need for wholesale changes to the structure of the LEC price cap plan given the lack of competition in the exchange market.[67] Ad Hoc shows (pp. 17-18), for example, that a "general restructuring of the current baskets and bands, however, is not warranted by current market conditions." Likewise, TCG demonstrates (p. 3) "that the state of local competition does not justify any changes today in price cap regulation" for the LECs. Indeed, WilTel suggests (pp. 2-5) that if anything, the current plan should be strengthened to prevent unreasonable discrimination because if competition should develop in the local exchange, LEC incentives to discriminate will increase.

The LECs, on the other hand (and not surprisingly) claim that their regulatory burdens should be reduced. In particular, LECs assert that the basket and band structure has become too complex and should be simplified, and virtually all of the LECs support USTA's proposed extensive revisions to the basket and band structure, which were also included in a petition filed

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67 See, e.g., ALTS, p. 12; Ad Hoc, p. 17; MCI, p. 17; TCG, p. 3; Time Warner, pp. ii, 6.

at the Commission by USTA on September 17, 1993.[68] In that petition, USTA requested effectively the same reform of the interstate access rules as it proposes here.[69]

In AT&T's view, there is no need to change the manner in which new LEC services are regulated under price caps.[70] Although the LECs express concerns about

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68 See, e.g., Ameritech, p. 9; Bell Atlantic, p. 21; BellSouth, pp. 25-29; GTE, pp. 57-62; Lincoln, p. 13; SWBT, pp. 77, 85-87; U S WEST, pp. 12, 14, 30.

69 See Public Notice, dated October 1, 1993, RM-8356. As shown in Part I above, the bulk of USTA's proposal to abandon much of the current price cap scheme is unwarranted and premature because no effective competition yet exists in the access market.

70 See Transport Rate Structure and Pricing, 9 FCC Rcd. 615, 622-27 (1994) ("Second Transport Order"). There is likewise no basis for the Commission to require index adjustments to AT&T's price caps for changes in CAP-provided, as well as LEC, access costs under the guise of "equalizing" the regulatory treatment of these entities. The LECs predictably say that they should be regulated like CAPs (see, e.g., Ameritech, p. 27; Bell Atlantic, p. 23; BellSouth, pp. 66-69; GTE, p. 64; NYNEX, p. 50; Rochester, p. 16; SWBT, p. 54; U S WEST, p. 62;) and the CAPs equally predictably say there is no reason to equalize the regulation of LECs and CAPs (see, e.g., MFS, p. 32; TCG, p. 13). No one disputes, however, that AT&T's use of CAPs is de minimis -- especially for the Basket 1 switched services that remain subject to price cap regulation. As AT&T showed (p. 46 n.76), unless and until this changes, there is no need to change the rules for computing AT&T's access charge flow through to equalize treatment of LEC and CAP access rate changes. Indeed, as the Pacific Companies recognize (p. 66), the "robust competition in the long-distance market . . . will assure that all reductions in AT&T's input costs, including access charge reductions, will be flowed through." Thus, if anything, neither LEC nor CAP access reductions should be treated exogenously.

unnecessary delay and harmful advance notice to competitors,[71] other commenters show that there has been no detrimental effect on the introduction of new services. They point out that any delayed introduction of new services is likely to have occurred not because of regulation, but simply because a LEC decided to delay the introduction of a service with little initial demand or no readily available substitutes.[72] Indeed, USTA itself shows (p. 18) that under the existing rules, price cap LECs have introduced "approximately 440 new services" in a little over three years -- contrary to its conclusion (id.) that the current rules "present substantial barriers to the introduction of new services."[73]

Nothing in the comments refutes, however, AT&T's showing (pp. 40-45) that two measured changes to the LEC price cap plan are appropriate to further ensure that the plan achieves its goals. First, LEC actions

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71 See, e.g., Ameritech, p. 22; Bell Atlantic, p. 23; BellSouth, p. 60; GTE, p. 39; Lincoln, p. 13; NYNEX, pp. 41-43; Pacific Companies, p. 60; Rochester, pp. 15, 23; SNET, p. 13; SWBT, p. 73; USTA, pp. 18-19; U S WEST, pp. 14, 50.

72 See, e.g., Ad Hoc, p. 28; ICA, pp. 19-20; MFS, p. 21; PaOCA, p. 10; Sprint, p. 21; TCG, p. 12; WilTel, pp. 27-29.

73 A number of parties expressed specific concern with the proposal (NPRM, 8 FCC Rcd. at 1702) to defer scrutiny of new services until they are included in price cap indices. See, e.g., MCI, p. 56; ICA, p. 20; MFS, pp. 28-29.

have confirmed the critical need for the Commission's continued monitoring of LEC assignments of services to baskets and subcategories. The Commission must confirm that these assignments are done correctly and consistently by all LECs to avoid future strategic or anticompetitive pricing. Second, zone density pricing differentials should be permitted only upon a clear and convincing showing by the LECs of geographical cost differences for the affected service, and when zone density pricing is permitted, the Commission should establish a "low density index" with a one percent upward ceiling.[74] These two changes will ensure that improper rate differentials do not arise and will prevent undue rate increases for rural or residential access customers.

Likewise, AT&T suggested (pp 46-52) that to maintain appropriate efficiency incentives the Commission should, consistent with the existing exogenous cost rules,[75] require exogenous treatment for: (i) fully

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[74] The continued validity of the zone density pricing concept would appear to be in doubt given the recent decision of the United States Court of Appeals for the District of Columbia Circuit overturning the Commission's expanded interconnection requirements, which were the basis for allowing the LECs to use zone density pricing. Bell Atlantic Corporation v. FCC, No. 92-1619 (D.C. Cir. June 10, 1994). See also Teleport Communications Group Inc., Petition for Declaratory Ruling, CC Docket No. 91-141, filed June 10, 1994.

[75] In addition to the exogenous cost categories listed in Section 61.45(d) of the Commission's Rules, the Commission has the flexibility to "permit or require"

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amortized equal access network reconfiguration ("EANR") costs; and (ii) costs associated with the sale of exchanges. The amortization of EANR costs is now complete, and treating them as exogenous is fully consistent with the Commission's treatment of other LEC amortizations.[76] Similarly, when a price cap LEC sells an exchange, substantial network costs that are embedded in its price caps are eliminated. Requiring the selling carrier to reflect these cost savings in an exogenous change to PCIs is necessary to ensure that the price cap formula does not lead to unreasonably high rates and that a LEC's decision to sell an exchange is made for appropriate business reasons, including improved efficiency and service quality, as NRTA (p. 2) and the NPRM (9 FCC Rcd. at 1704) recognize.[77]

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other costs to be treated exogenously when it deems such treatment to be appropriate. Nothing has changed in the exchange market that would warrant any change in these rules at this time. See Ameritech, pp. 18-19; BellSouth, pp. 54-57; CCTA, p. 8; GTE, p. 78; NYNEX, p. 60; Pacific Companies, p. 54; Rochester, pp. 21-22; SNET, p. 14; SWBT, p. 51; Sprint, p. 19; USTA, p. 87.

76 See, e.g., LEC Price Cap Order, 5 FCC Rcd. at 6808 (depreciation reserve deficiencies).

77 AT&T also agrees with NRTA (p. 5) that questions regarding universal service support mechanisms, how they are constructed and how they may be affected by sales of exchange, are beyond the scope of this proceeding, but should be examined thoroughly by the Commission. This should not delay, however, implementation of the requirements that the selling

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CONCLUSION

For the reasons shown above and in AT&T's Comments, the Commission should recognize that no relaxation of its current incentive regulation plan is warranted so long as the LECs retain their monopoly control over local exchange and exchange access services. Any modification of these stringent controls should come only after the prerequisites to effective local exchange competition have been implemented, and objective evidence is available demonstrating the existence of viable competition for these indispensable services. Pending these developments, the Commission should adopt the

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price cap LEC treat eliminated network costs exogenously and that the Commission's approval of the sale be conditioned upon an appropriate showing by both parties to the transaction that the sale will not increase access customers' overall charges either via higher access rates or increased subsidy payments. The need for this condition is evident from OPASTCO's candid admission (p. 3) that the sale of exchanges "merely shifts the recovery of infrastructure and service costs from one set of contributors (the original LECs' low-cost urban customers) to another (the customers of interstate interexchange carriers)."

measured improvements in its LEC price cap plan described by AT&T to assure that its objective of just and reasonable access rates continues to be achieved.

Respectfully submitted,

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June 29, 1994

OTHER PARTIES SUBMITTING COMMENTS
IN CC DOCKET NO. 94-1

Ad Hoc Telecommunications Users Committee ("Ad Hoc")
Aeronautical Radio, Inc. ("ARINC")
American Library Association ("ALA")
Illinois Bell Telephone Company; Indiana Bell Telephone Company, Inc.; Michigan Bell Telephone Company; The Ohio Bell Telephone Company; and Wisconsin Bell, Inc. ("Ameritech")
Association for Local Telecommunications Services ("ALTS")
Bell Atlantic - Delaware, Inc.; Bell Atlantic - Washington, D.C., Inc.; Bell Atlantic - Maryland, Inc.; Bell Atlantic -New Jersey, Inc.; Bell Atlantic - Pennsylvania, Inc.; Bell Atlantic - Virginia, Inc.; Bell Atlantic - West Virginia, Inc. ("Bell Atlantic")
BellSouth Telecommunications, Inc. ("BellSouth")
California Cable Television Association ("CCTA")
Cincinnati Bell Telephone Company ("CBT")
Citizens for a Second Economy Foundation ("CSE Foundation")
Competitive Telecommunications Association ("CompTel")
Computer & Communications Industry Association ("CCIA")
General Services Administration ("GSA")
GTE Service Corporation ("GTE")
Intermedia Communications of Florida, Inc. ("ICI")
International Communications Association ("ICA")
Lincoln Telephone and Telegraph Company ("Lincoln")
Eagle Telephone, Inc.; Summa Four, Inc.; LC Technologies, Inc.; Ambox Incorporated; AmPro Corporation; Axes Technologies, Inc.; Teradyne, Inc.; Inovonics, Inc.; Perception Technology Corp.; OK Champion Corporation; Lingo, Inc.; Tamaqua Cable Products Corp.; Remarque Mfg. Corp.; Rhetorex, Inc.; Centigram Comm. Corp.; HealthTech Services Corporation; American Reliance Inc.; Senecom Voice Processing Systems; Technology Service Group; Intelect, Inc. ("Manufacturers")
MFS Communications Company, Inc. ("MFS")
MCI Telecommunications Corporation ("MCI")
National Rural Telecom Association ("NRTA")
National Telephone Cooperative Association ("NTCA")
New York Telephone Company and New England Telephone and Telegraph Company ("NYNEX")
Office of the Consumers' Counsel, State of Ohio ("OCCO")
Organization for the Protection and Advancement of Small Telephone Companies ("OPASTCO")
Pacific Bell and Nevada Bell ("Pacific Companies")
Pennsylvania Office of Consumer Advocate ("PaOCA")
Rochester Telephone Corporation ("Rochester")
The Southern New England Telephone Company ("SNET")
Southwestern Bell Telephone Company ("SWBT")
Sprint Corporation ("Sprint")

Council of Chief State School Officers; National Association of Secondary School Principals ("Schools")
Tele-Communications Association ("TCA")
Teleport Communications Group, Inc. ("TCG")
Time Warner Communications ("Time Warner")
United States Telephone Association ("USTA")
U S WEST Communications, Inc. ("U S WEST")
WilTel, Inc. ("WilTel")